

Internal Revenue Service  
Appeals Office  
P.O. Box 24018, Stop 55203  
Fresno, CA 93779-4018

Release Number: **201143035**  
Release Date: 10/28/2011  
Date: August 4, 2011

A

B

Department of the Treasury

Person to Contact:

Employee ID Number:

Tel:

Fax:

Refer Reply to:

In Re:

EO Revocation

Form Required to be Filed:

1120

EIN:

D

Tax Period(s) Ended:

C

UIL: 501.32-00

### Certified Mail

Dear

This is a final adverse determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code (IRC). It is determined that you do not qualify as exempt from Federal income tax under IRC Section 501(c)(3) effective January 1, 2003.

Our adverse determination was made for the following reason(s):

Organizations exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code are required to operate exclusively for charitable, education, or other exempt purposes. Organizations are not operated exclusively for exempt purposes if the net earnings of the organization inure in whole or in part to the benefit of private shareholders or individuals of the organization. See Treas. Reg. § 1.501(c)(3)-1(c)(2).

During 2003, 2004, and 2005 we have determined that your net earnings inured to the benefit of your founders through a series of transactions whereby substantial sums were withdrawn from your business bank account by your founders without sufficient demonstration that such amounts were expended to further your exempt purposes and through further transactions directly benefitting only your founders such as expenditures for their personal clothing and travel. The funds inuring to your founders were substantial in comparison to your total operations and were multiple or repeated over a pattern of years. You have not implemented safeguards to prevent a recurrence of funds inuring to your

founders and lack sufficient operational controls. As such, you have not operated exclusively for exempt purposes and have operated for the benefit of private interests of individuals in contravention of the requirements of Treas. Reg. 1.501(c)(3)-1(d)(1)(ii).

Contributions to your organization are not deductible under section 170 of the Code.

You are required to file Forms 1120, U.S. Corporation Income Tax Return, for tax periods beginning on and after January 1, 2003. File the returns in accordance with their instructions and do not send them to this office. Processing of income tax returns and assessment of any taxes due will not be delayed because you have filed a petition for declaratory judgment under IRC code section 7428.

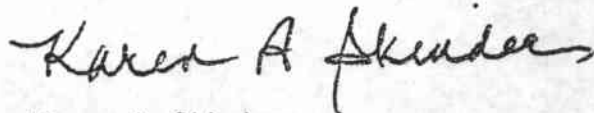
If you decide to contest this determination under the declaratory judgment provisions of Code section 7428, a petition to the United States Tax Court, the United States Court of Claims, or the district court of the United States for the District of Columbia must be filed within 90 days from the date this determination was mailed to you. Contact the clerk of the appropriate court for rules for filing petitions for declaratory judgment. To secure a petition form from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W. Washington, D.C. 20217.

We will notify the appropriate State officials of this action, as required by Code section 6104(c). You should contact your state officials if you have any questions about how this determination may affect your state responsibilities and requirements.

You also have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures such as the formal appeals process. The Taxpayer Advocate is not able to reverse legally correct tax determinations, nor extend the time fixed by law that you have to file a petition in the U.S. Tax Court. The Taxpayer Advocate can however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this letter. See the enclosed Notice 1214, *Helpful Contacts for Your "Notice of Deficiency"*, for Taxpayer Advocate telephone numbers and addresses.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,



Karen A. Skinder  
Appeals Team Manager

Enclosure: Notice 1214 Helpful Contacts for your "Notice of Deficiency"



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY

Internal Revenue Service  
TE/GE Division, EO Group 7983  
9350 Flair Dr. 2nd Floor  
El Monte, CA 91731-2885

Taxpayer Identification Number:

Form:

990

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear :

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, take no further action. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

Letter 3618 (04-2002)  
Catalog Number 34809F

If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

300 N. Los Angeles St.  
Room 5109, Mail Stop 6710  
Los Angeles, CA. 90012

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Sunita B Lough  
Director, EO Examinations

Enclosures:  
Publication 892  
Publication 3498  
Report of Examination

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer ORG (EIN)		Years Ended 12/31/20XX- 12/31/20XX

#### LEGEND

ORG - Organization name      XX - Date      City - city      State - state  
 President - president      Director - director      CO-1 through CO-33 = 1<sup>st</sup> through  
 33<sup>rd</sup> COMPANIES

### ISSUES

Should ORG Daycare's tax-exempt status under Internal Revenue Code section 501(c)(3) be revoked because of inurement?

### FACTS

The subject organization is recognized as a section 501(c)(3) tax-exempt organization. The organization was granted exempt status in December 19XX. In 20XX, the organization had two daycare centers in City and City, State. To date, the organization has expanded to include two more locations in City and City, State. According to its articles of incorporation, the specific purpose of the organization is to operate a nonprofit corporation daycare that will provide a quality daycare environment for infants and toddlers. The organization will provide the proper love and care and high self-esteem to become accepted in today's society. Educational as well as recreational activities will be provided along with in-center activities. The care of the children will allow parents to be gainfully employed.

A tour of the facilities revealed the typical attributes and activities of a daycare center. The organization provides both educational and recreational activities in the center daily along with occasional field trips to the beach, movies, zoo etc. The daycare is open Monday through Friday from 6 am – 6 pm and accepts infants, toddlers and school age children. The organization participates in government and subsidized tuition and food programs and therefore a large majority of its revenue is derived from these programs. The organization does not participate in any fundraising activities.

Per Director's oral testimony, the organization was audited for the tax year 20XX and assessed unpaid employment taxes and related interest and penalties. It currently is on an installment agreement to repay outstanding amounts owed. Per Director, she was not aware that the previous accountant was not filing the required employment tax returns.

Director is both the director of the daycare and the vice-president of the organization. Her husband, President, is listed as the president. The only salaried board member is Director. There are very limited internal controls established and President and Director are the only board members with signing privileges on the checking account. They write all of the checks and deposit the income themselves.

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer ORG (EIN)		Years Ended 12/31/20XX- 12/31/20XX

An examination of the organization's bank account for the three years ending December 31, 20XX through December 31, 20XX revealed that there is a significant amount of large, unusual, and questionable debits. A breakdown of these items are as follows:

**Large, unusual, and questionable debits from the organization's checking acct.**

	<u>Year: 20XX</u>	<u>Year 20XX</u>	<u>Year 20XX</u>
In-Branch Cash Withdrawals			
Clothing			
Travel			
ATM Cash Withdrawals			
Electronic Transfers to Savings Account			
CO-1			
CO-2			
CO-3			
CO-4			
Restaurants			
CO-5			
CO-6 – President			
CO-7			
CO-8			
City CO-9			
Demo #21			
CO-10			
Miscellaneous			
Bank Charges			
Automobile Expenses			
Leasing Services			
CO-11. Payments			
CO-12 (Director & President			
Storage			
Florists			
CO-13-Director			
Return Item			
Return Item Fee			
Nix Check Fee			
On-Line			
CO-14.-Director			
CO-15 Director			
<b>Total</b>			\$



Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer ORG (EIN)		Years Ended 12/31/20XX- 12/31/20XX

A detailed spreadsheet listing the large, unusual, and questionable debits was provided to the EO director for the three years ending December 31, 20XX through December 31, 20XX. A review of the bank statements revealed a similar pattern of large, unusual, and questionable debits and/or withdrawals (i.e, in-branch w/drawls, ATM, withdrawals, clothing purchases, travel etc.) throughout the years. To date, the EO director has only provided documentation as it relates to the calendar year ending December 31, 20XX. The organization made frequent large in-branch withdrawals each month. Additionally, the organization frequently withdrew cash from ATMs each month. Initially, per the director's written response, in-branch and cash withdrawals were made to pay for playground equipment since the organization was new and did not have credit established. Copies of estimates were provided by the organization but no substantiation was provided to establish how and when payments were made. Third party letters were sent to the vendors provided by the EO. CO-16 provided copies of paid invoices for equipment purchased by the EO but the invoices are related to the year 20XX. There were no unpaid balances carried over to subsequent years. No invoices were provided for the year 20XX which is the year being audited. No other explanation or documentation was provided for the large withdrawals. Refer to Exhibit A for a schedule of detailed debits related to in-branch and ATM withdrawals.

The director stated that cash was used to purchase various items for the daycare. Refer to Exhibit B for a detailed listing of items purchased with cash. On May 21, 20XX, the EO provided invoices, estimates, and/or receipts to substantiate the detailed listing in Exhibit B. A thorough review of the substantiation revealed that the majority of the purchases were food related items from CO-17, CO-18 and CO-19. Third party verification IDRs were sent to the three vendors and a response was received from CO-17 stating that it did not accept cash as a form of payment. Further, the account was not current as there is an outstanding balance owed. The invoices related to CO-18 and CO-19 list amounts due but the agent is unable to determine if the amounts were ever paid. In addition, if payments were made, it could not be determined the method of payment. Per Director, the EO purchased food from the three vendors for the daycare and the CO-22 program.

Third party IDRs were sent to the vendors with the largest amounts since the majority of the invoices do not indicate if the invoices were paid in full or the method of payment. Responses were received from CO-20, CO-21, CO-22, CO-23, and CO-24. None of the responses indicated that a service was provided or a sales transaction was actually completed. They all appear to be estimates. Further, the response from CO-22 did not provide verification of BOJ's involvement with the program and a substantial portion of the expenditures were related to BOJ's involvement with CO-22. They were food purchases, misc. supplies, equipment etc. Therefore, the invoices provided above failed to establish how the expenditures furthered the organization's exempt purpose.

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer ORG (EIN)		Years Ended 12/31/20XX- 12/31/20XX

Some invoices provided actually list the method of payment as check and indicates the check number.

Invoices were provided for educational supplies purchased from vendors such as CO-25. The invoices from CO-25 list a completely different organization for billing purposes. Further, there is no indication that the amount was paid by BOJ or the method of payment.

A bill of sale from CO-26 was provided but the bill of sale indicates that the vehicle was to be used for personal purposes. Proof of insurance was not provided. Further, there is no indication of the method of payment and the agent is unable to reconcile the date on the bill of sale to the in-branch cash withdrawal date. Additionally, the invoice provided above failed to establish how the expenditure furthered the organization's exempt purpose.

The review of questionable debits also revealed purchases made to clothing retailers such as Chadwick's, Lerner's, Nordstrom's, Ann Taylor, Motherhood Maternity, Dukes Men's Store, Gods Woman Co., Urban Underground Outlet, Hollywood Suit Outlet, LaRedoute, and Van Heusen. Purchases were also made at Big 5 Sporting Goods and the Jewelry Exchange. Some purchases were also made on-line. Per the director's written explanation, the clothing store purchases were clothes allowances for marketing purposes. Some were for parent donations for referring children to its facility and others for attending parent training meetings. No substantiation for the clothing purchases other than the written explanation was provided. The director, who is married to the president and board member of the organization, was pregnant in 20XX when purchases were made to Motherhood Maternity and has a teen age son. The clothing appears to be personal in nature. Since the officers were the only individuals that had full control and authorization of the organization's checking account, it appears that expenditures were used for the benefit of the officers. Refer to Exhibit A for a detailed schedule of debits related to the above stated purchases.

Purchases were made for airline tickets and related hotel accommodations for travel to states such as State and State. Per the director's written explanation, the director, head teacher, and teacher's aide traveled to these states to observe another daycare and get new marketing ideas. The exempt purpose in addition to the necessity to travel out of state to observe daycares has not been established. Moreover, a review of the organization's checking account reveals that the account was debited \$ on July 21, 20XX for travel related expenditures to City, State. Clothes were purchased the same day at Ann Taylor and Dukes Men's Store (both clothing department stores) for \$ and \$, respectively. On August 18, 20XX, lodging accommodations at the hotel CO-27 in City, State for \$ was debited from the organization's checking account. The account was also debited the same day for CO-28 photography (local photography retailer in City, State) in the amount of \$, \$ to CO-29 and \$ to



<b>Form 886-A</b>	<b>EXPLANATION OF ITEMS</b>	<b>Schedule or Exhibit No.</b>
<b>Name of Taxpayer ORG (EIN)</b>		<b>Years Ended</b> 12/31/20XX- 12/31/20XX

Tommy Hilfiger Outlet in City, State. No substantiation for the travel other than the written explanation was provided. Refer to Exhibit A for a detailed schedule of debits related to the above stated purchases.

Purchases were made from CO-2 which is a children's retail store. Three separate purchases were made in October 20XX for \$\$ and \$. Per the director's written explanation, these purchases were for baby shower gifts but no substantiation to support this statement has been provided. The director was pregnant in 20XX and subsequently had her baby in early 20XX.

The organization has failed to provide contemporaneous documentation and explanations for the remaining expenses. The charitable purpose of the expenses has not been established. Refer to Exhibit A for a detailed schedule of debits related to the above stated purchases.

Subsequently on May 21, 20XX, Director provided a handwritten receipt indicating that the purchase from CO-2 represented a one time purchase for infant cribs. The receipt does not represent a valid receipt from CO-2 and therefore it can not be determined that the associated funds were used to further the organization's exempt purpose.

The director, Director, is the only salaried board member but the bank statements revealed an electronic funds transfer to President on June 23, 20XX for \$. An explanation or documentation of the exempt purpose of this transfer has not been provided.

The examination of the organization determined that no one other than President and Director had access to the organization's checking account. A review of the minutes did not reveal that the other board members were aware of the large in-branch and ATM withdrawals. There was no discussion of playground equipment purchases. Further, the only asset listed on the balance sheet of the as-filed 990 is cash and no depreciation has been claimed. This is not consistent with the purchase of depreciable assets such as playground equipment.

There were numerous monthly debits from the checking account for purchases made to various gas stations for gas and for oil changes. Although the organization did have a company van used to transport the children to and from activities and school, the amounts appear to be excessive. Further, per Director's oral testimony, the organization did not provide any board members with a vehicle. The director resides in City, State. and commutes daily to the daycare centers in City, State. The frequency of the gasoline purchases and oil changes is more consistent with the director's long commute. Refer to Exhibit A for a detailed schedule of debits related to automobile expenses.

There were also numerous purchases made to CO-30, CO-31, CO-32, CO-33 and various grocery stores that were not included in the agent's workpaper of large, unusual and

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer ORG (EIN)		Years Ended 12/31/20XX- 12/31/20XX

questionable debits. The director's written explanations for these purchases were that they were for various supplies that the individual daycare centers needed and that personal and business purchases were not co-mingled. The review of the cancelled checks reveals checks written to various vendors for supplies in addition to these debit card purchases. Although the credibility of the director's testimony is in question and no substantiation has been provided to support the claim that business and personal purchases were not co-mingled, it appears that the purchase of supplies from those retailers is reasonable.

The review of the organization's bank statements also reveal frequent debits for overdraft, non-sufficient funds and bank card fees. The amounts are excessive in nature and the exempt purpose of the expenses has not been verified. Refer to Exhibit A for a detailed schedule of debits related to bank fees.

A review of the organization's cancelled checks reveals that the organization appears to be incurring and paying for normal expenditures such as utilities, supplies, food, tax and licenses etc... Although there appears to be legitimate business expenses paid from the organization's checking account, the charitable purposes of the questionable items have not been well established. Further, no documentation has been provided to support the director's explanation for the amounts.

The EO has not provided any explanations or substantiation for the large, unusual, and/or questionable items for calendar years ending December 31, 20XX through December 31, 20XX.

#### **Financial Information**

ORG Daycare's Form 990 for the year ending December 31, 20XX through December 31, 20XX reported revenue and expenses as follows:

Revenue		20XX	20XX	20XX
Program service revenue				
Total Revenue	\$			
Expenses				
Compensation of officers	\$			
Other salaries				
Other employee benefits				
Accounting fees				
Legal fees				
Telephone				

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer ORG (EIN)		Years Ended 12/31/20XX- 12/31/20XX

Postage and shipping	-	
Occupancy		
Printing and publications	-	
Travel		
Interest	-	-
Depreciation, depletion, etc.	-	
Other expenses		
Total Expenses		\$

## LAW

Section 501(c)(3) of the Code exempts from federal income tax organizations organized and operated exclusively for charitable, educational, and other exempt purposes, provided that no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the regulations provides that in order to be exempt as an organization described in section 501(c)(3) of the Code, the organization must be one that is both organized and operated exclusively for one or more of the purposes specified in that section.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will not be regarded as operated exclusively for exempt purposes if more than an insubstantial part of its activities is not in furtherance of exempt purposes.

Regulation section 1.501(c)(3)-1(c)(2) provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. The words "private shareholder or individual" refer to persons having a personal and private interest in the activities of the organization. The term "private shareholder or individual" is defined in regulation section 1.503(a)-1(c).

Section 1.501(c)(3)-1(d)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Regulation section 1.501(c)(3)-1(f), interaction with Section 4958, provides for the application of five factors when revocation is pursued on inurement grounds. In determining whether to

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer ORG (EIN)		Years Ended 12/31/20XX- 12/31/20XX

continue to recognize the tax-exempt status of an applicable tax-exempt organization (as defined in section 4958(e) and §53.4958-2) described in section 501(c)(3) that engages in one or more excess benefit transactions (as defined in section 4958(c) and §53.4958-4) that violate the prohibition on inurement under section 501(c)(3), the Commissioner will consider all relevant facts and circumstances, including, but not limited to, the following —

(A) The size and scope of the organization's regular and ongoing activities that further exempt purposes before and after the excess benefit transaction or transactions occurred;

(B) The size and scope of the excess benefit transaction or transactions (collectively, if more than one) in relation to the size and scope of the organization's regular and ongoing activities that further exempt purposes;

(C) Whether the organization has been involved in multiple excess benefit transactions with one or more persons;

(D) Whether the organization has implemented safeguards that are reasonably calculated to prevent excess benefit transactions; and

(E) Whether the excess benefit transaction has been corrected (within the meaning of section 4958(f)(6) and §53.4958-7), or the organization has made good faith efforts to seek correction from the disqualified person(s) who benefited from the excess benefit transaction.

The presence of a single substantial nonexempt purpose can destroy the exemption regardless of the number or importance of exempt purposes. Better Bus. Bureau v. United States, 326 U.S. 279, 283, 90 L. Ed. 67, 66 S. Ct. 112 (1945); Am. Campaign Acad. v. Commissioner, 92 T.C. 1053, 1065 (1989); see also Old Dominion Box Co., Inc. v. United States, 477 F.2d. 340 (4<sup>th</sup> Cir. 1973), cert. denied, 413 US 910 (1973) ("operating for the benefit of private parties who are not members of a charitable class constitutes a substantial nonexempt purpose"). When an organization operates for the benefit of private interests, such as designated individuals, the creator or his family, or persons directly or indirectly controlled by such private interests, the organization by definition does not operate exclusively for exempt purposes. Am. Campaign Acad. v. Commissioner, supra at 1065-1066.

In Spokane Motorcycle Club v. U.S., 222 F. Supp. 151 (E.D. Wash. 1981), net profits were found to inure to private individuals where refreshments, goods and services amounting to \$825 (representing some 8% of gross revenues) were furnished to members.

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer ORG (EIN)		Years Ended 12/31/20XX- 12/31/20XX

In Revenue Ruling 67-5, 1967-1 C.B. 123, it was held that a foundation controlled by the creator's family was operated to enable the creator and his family to engage in financial activities which were beneficial to them, but detrimental to the foundation. It was further held that the foundation was operated for a substantial non-exempt purpose and served the private interests of the creator and his family. Therefore, the foundation was not entitled to exemption from Federal income tax under section 501(c)(3).

Regulation section 31.6001-1(a) states in part that organizations, "...shall keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown by such persons in any return of such tax or information."

Regulation section 1.6033-2(i)(2) states, "Every organization which is exempt from tax, whether or not it is required to file an annual information return, shall submit such additional information as may be required by the Internal Revenue Service for the purpose of inquiring into its exempt status and administering the provisions of subchapter F (section 501 and following), chapter 1 of subtitle A of the Code, section 6033, and chapter 42 of subtitle D of the Code."

Revenue Ruling 59-95 provides that a failure to file required information return or comply with the provision of section 6033 of the Code and the regulations which implement it, may result in the termination of the exempt status of an organization previously held exempt, on the grounds that the organization has not established that it is observing the conditions required for the continuation of an exempt status

In Church of Gospel Ministry v. United States, 640 F. Supp 96 (D DC 1986), the court ruled that a failure to keep and present accurate and adequate records prevented the Church from meeting its burden of showing that its operations were primarily for charitable purposes and did not inure to the private benefit of its officers. The court also stated that, "...the lack of adequate records or receipts...makes it impossible for CGM to establish that it is not being operated for the private benefit of its members and provides independent grounds for rejecting its claim to tax-exempt status."

#### **TP'S POSITION**

TP's position is unknown at this time.

#### **GOVERNMENT'S POSITION**

Regulation section 1.501(c)(3)-1(f), interaction with Section 4958, provides for the application of five factors when revocation is pursued on inurement grounds. Factors for consideration



<b>Form 886-A</b>	<b>EXPLANATION OF ITEMS</b>	<b>Schedule or Exhibit No.</b>
<b>Name of Taxpayer</b> ORG (EIN)		<b>Years Ended</b> 12/31/20XX- 12/31/20XX

include the size and scope of the organization's ongoing activities that further exempt purposes before and after the excess benefit transaction(s) occurred; the size and scope of the excess benefit transaction(s) in relation to the size and scope of the organization's activities that further exempt purposes; whether the organization was involved in multiple excess benefit transactions; whether the organization has implemented any safeguards to prevent any excess benefit transactions and whether the excess benefit transaction has been corrected. Based on the facts of the examination, the organization does not qualify for exemption since the excess benefit transaction has risen to a level where the organization's exempt function, on the whole, is called into question. There appears to be a pattern of large, unusual, and questionable withdrawals and debits from the organization's bank accounts that have not been adequately substantiated. Further, there are virtually no internal controls as the director of the daycare, Director and her spouse are the only ones with signing privileges on the checking account. They write all of the checks and deposit the income themselves. No other safeguards have been implemented and correction has not been made. Although the purpose in operating the daycare centers may arguably benefit the public and community as a whole, it appears that the director of the organization is using the organization's funds for personal purposes. The charitable purpose of the large, unusual and questionable withdrawals and debits have not been established.

### **CONCLUSION**

Based on the foregoing reasons, the organization does not qualify for tax exemption under section 501(c)(3) due to inurement of the organization's funds to Director. Therefore, ORG's tax exempt status should be revoked effective January 1, 20XX.